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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-378

THE BANK OF NEW JERSEY,

Petitioner,

vs.

NORTHWESTERN NATIONAL INSURANCE COMPANY,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The Petitioner, The Bank of New Jersey, respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Third Circuit entered in this proceeding on June 13, 1977.

OPINIONS BELOW

The opinions of the United States District Court for the District of New Jersey (Civil Action No. 929-72) in this matter were not published. The original written opinion of the District Court on the issue of liability is set forth in the Appendix hereto (App. 25a), as is the oral opinion of the District Court on the issue of damages (App. 17a). The opinion of the United States Court of Appeals for the Third Circuit (No. 76-2069) has not yet been officially reported, and is also set forth in the Appendix hereto (App. 1a).

JURISDICTION

The judgment and opinion of the Court of Appeals for the Third Circuit were entered on June 13, 1977, and this Petition for Writ of Certiorari was filed within 90 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

1. When a 5 year loan is evidenced by a one year renewable promissory note which includes an acceleration clause permitted by N.J. Stat. Ann. §12A:1-208, and the primary collateral for the note is a one year Bond, (which extends 7 days beyond the maturity of the note), does the creditor have the right prior to permitting renewal of the note to demand additional collateral in the form of an extension of the Bond when there are grounds for insecurity in addition to the pending expiration of the Bond, namely, five months default in the payment of interest by the debtor?

2. Under the common law of New Jersey may a debtor renew a promissory note without tendering to the creditor a renewal note in the same form as the original note duly executed by the maker of the note?

STATUTES INVOLVED

N.J. Stat. Ann. §12A:1-208 is set forth in Point II, below.

STATEMENT OF THE CASE

In February 1971, the Bank of New Jersey (hereinafter the Bank) agreed to lend $250,000 over a period of five (5) years to Brokers Financial Corporation (hereinafter Brokers) to finance the completion of the construction of an apartment building in Ventnor, New Jersey (App. 2a).

The first year of the loan was evidenced by a one-year promissory note which was executed on April 7, 1971 by the President and Secretary of Brokers. Interest only (at a rate of 8%) was payable during the first year of the loan, and the note contained a provision that "although written for a period of one year, if interest is paid as agreed this note may be renewed" (App. 25a).

The printed portion of the note contained an acceleration clause of the type permitted by N.J. Stat. Ann. Section 12A:1-208 (App. 3a). This clause permitted the Bank to make demand for additional collateral if the Bank should determine at any time when the note was in effect that the collateral for the loan was insufficient (App. 29a). The clause reads as follows:

> . . . each of the undersigned hereby agrees, whenever the total value of the collateral so held by the holder hereof shall be insufficient in character, kind or amount in the holder's sole opinion and discretion to cover all indebtedness and liabilities as aforesaid of any of the undersigned to the holder hereof, with a margin added thereto satisfactory to the holder, to immediately reduce such indebtedness and liabilities or to deposit with the holder additional collateral to the satisfactiton of the holder within two hours after demand made orally, or within twelve hours after demand made in writing addressed to the undersigned and delivered at any address shown on the records of the holder hereof; or within twenty-four hours after demand made by letter deposited in the United States mail with postage prepaid addressed to the undersigned at any address shown on the records of the holder hereof, or at the last known residence or place of business of the undersigned, and in default thereof this note shall forthwith without further demand or notice, and regardless of whether otherwise due by the terms hereof or not, become immediately due and payable.

As collateral for this loan, Brokers assigned to the Bank a second lien on the Ventnor property, and also provided a one year $250,000 Financial Guarantee Bond issued by Northwestern National Insurance Company (Northwestern) (App. 26a). The Bond, rather than the mortgage on the Ventnor property, constituted the primary security for the loan (App. 10a). The Bond, prepared by Northwestern, was sent to the Bank for approval prior to its final execution (App. 4a). The Bond is dated April 16, 1971,

nine days after the note. The Bond was renewable at the option of the Guarantor and provided that the Bank was to notify Northwestern of any default by Brokers in the payment of monthly installments of interest, whereupon Northwestern would have ten days to cure the default and preserve Brokers' rights under the note (App. 26a). The Bond on its face is a Guarantee by Northwestern of all of Brokers' obligations under the note.

Brokers failed to pay interest for the months of November, 1971 through March, 1972 (App. 27a). The Bank then notified Northwestern which made timely payment pursuant to the Bond and cured Brokers' default in failing to pay interest (App. 6a).

The fact that interest had been in default for 5 months caused the Bank to re-evaluate the collateral which it held. The $250,000 Bond was adequate in amount during the time period when it would be in effect, but the Bank determined that as collateral it was insufficient in duration (in light of the probable renewal of the note (App. 14a)) based upon Brokers' difficulties at the apartment complex (App. 6a) and especially in light of the 5-month default in interest payments (App. 29a). The Bank therefore wrote to Brokers on March 8, 1972 demanding an extension of Northwestern's Bond. No such Bond was ever produced by Brokers (App. 6a).

The failure to produce the renewal Bond was a default under the acceleration provision which entitled the Bank to call the loan. (This was the holding of the District Court (App. 29a). While the Court of Appeals suggests that this point might never have been raised in the proceedings before the District Court (App. 8a) the acceleration clause and its effects were specifically argued by counsel for the Bank in its Brief in Support of Motion for Summary Judgment.) According to the terms of the note, the obligation became due without further notice by the Bank.

On April 5, 1972, prior to the expiration of the note, the Bank notified Brokers that the loan would not be extended due to the default in the note and demanded payment in full of the obligation (App. 6a). That default was Brokers' failure to comply with the Bank's legitimate demand for additional collateral, a default which authorized the Bank to accelerate the payment of the debt to one year (App. 29a). Brokers, through an attorney, then tendered payment of the interest due in April and in that same letter the attorney stated that Brokers was renewing the Note (App. 27a). This was the first appearance by this attorney in the stipulated record before the District Court. No renewal note accompanied the letter, nor was any ever submitted. The Bank returned the interest which had been tendered and again demand payment in full (App. 27a). When Brokers failed to pay the note when due on April 7, 1972, the Bank made demand upon Northwestern to make payment pursuant to the terms of its Bond, which remained in effect until April 15, 1972. When no payment was forthcoming, this litigation was initiated.

The District Court held that the Bank's demand for additional collateral was valid and therefore upheld its acceleration of the note (App. 29a). It was therefore unnecessary for it to reach the question of whether the promissory note had been properly renewed. The Court of Appeals reversed the District Court's ruling as to the propriety of the Bank's demand for an extension of Northwestern's Bond. The question of renewal which had been argued and briefed before both the District Court and the Court of Appeals was therefore exposed, but it was never expressly answered by the majority opinion of the Court of Appeals. However, the effect of its decision is to hold that a promissory note may be renewed by a mere statement contained in a letter.

REASONS FOR GRANTING THE WRIT

Point I

The decision of the Court of Appeals is in conflict with the Common Law of the State of New Jersey.

The decision of the Court of Appeals that there was no default during the term of the Bond (and its determination that the loan remained in effect beyond the due date of the original note and beyond the expiration of the Bond) of necessity is a determination that the letter by Brokers' alleged attorney constituted an effective renewal of the note. This is in conflict with the Common Law of the State of New Jersey. *Byerly v. Randolph*, 103 N.J.L. 240, 133 A. 40 (Sup. Ct. 1926).

The question of the nature of the affirmative action which is necessary to effectuate the renewal of a promissory note is an important question of state commercial law. While promissory notes in general are governed by the Uniform Commercial Code (enacted in New Jersey at N.J. Stat. Ann. §12A:1-1, *et seq.*), there is no express provision of the Code which determines whether affirmative action is necessary to renew a promissory note. Anderson, Uniform Commercial Code, Section 3-109:10, p. 655 (1971). The question of the necessity for affirmative action for renewal is, of course, essentially a procedural question which must be carefully distinguished from the substantive question of the right to renew, which is expressly covered in the Code at N.J. Stat. Ann. §12A:3-118(f). It is, however, an important question for the commercial and banking communities which must constantly rely upon the use of promissory notes.

The Court below confused the two issues of the substantive right to renew versus the procedural steps necessary to effectuate renewal. It determined that the debtor had a right to renew as set forth on the face of the note (the Court also held that this right was not lost due to any default, as will be discussed below) and then proceeded to hold that the surety was not liable, thereby holding by necessary inference that there was an effective renewal of the note, a holding which is in conflict with applicable New Jersey law.

In *Byerly v. Randolph*, 103 N.J.L. 240, 133 A. 40 (Sup. Ct. 1926) the Court was faced with the question of whether a note which stated "renewal until paid" was automatically renewable. The note in question was in fact a renewal of a previous note. The defendant asserted that the plaintiff could not sue because the defendant was entitled to indefinite renewals. In rejecting this argument, the Court said:

> For, if the defendant's theory is sound that he was entitled to a renewal, at his option, when the renewed note became due and payable, according to its tenor, then he obviously failed to perform his part of the agreement, since he tendered no renewal note. 133 A. at 40.

Therefore, the law in New Jersey is that the tender of a renewal note is necessary to properly effectuate the renewal of a promissory note. Assuming that Brokers retained the right to renew it would have had to tender a renewal note in order to accomplish its purpose. A renewal note was never tendered and the unilateral statement of an attorney that he "renews" a note does not qualify as a promissory note with the appropriate signature of its maker, a corporation, by its duly authorized officers.

This conflict between the determination of the Court of Appeals and the Common Law of the State of New Jersey is an important conflict which deserves to be expressly resolved by this Court. This is especially true in

light of the failure of the Code to address the problem, and the importance of this question in daily commercial and banking practice.

Point II

The question of the Bank's right to demand additional collateral is an important question of substantive law which has never previously been decided under the Uniform Commercial Code.

The court below by its own admission made a precedent setting determination in a previously uncharted area of the law under the Uniform Commercial Code. The question which has been raised is of such importance that it is deserving of review by this court.

Brokers failed to make monthly payments of interest as they came due for a period of five months, and in fact made no payment of interest at all during that period despite the express typewritten provision of the note that interest was to be paid monthly. The District Court held that this five month default in the payment of interest constituted valid grounds under N.J. Stat. Ann. §12A:1-208 for a reasonable and honest creditor to doubt the security of the loan. This statute permits acceleration of a loan or demands for additional collateral where the creditor's actions are taken in good faith. It reads as follows:

> A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or "when he deems himself insecure" or in words of similar import shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against whom the power has been exercised.

Under the District Court's rationale the Bank was therefore entitled to demand additional collateral and accelerate the entire obligation when the additional collateral was not produced, and this acceleration took place during the term of the Bond. The Court of Appeals approached the question of acceleration by a different route. For all intents and purposes it ignored the fact of the five month interest default and instead concentrated on the expiration of the Bond and the fact that the Bank had contractually acquiesced in Brokers' initial tender of a one year Bond in April, 1971. The Court of Appeals held that the mere expiration of the one year Bond could not in itself form a valid basis for a "good faith" demand for additional collateral if the additional collateral which was demanded was an extension of the original Bond. The Bank would agree that as a general proposition of law the expiration of a Bond with a term shorter than that of a loan should not in itself serve as a valid basis for a demand for an extension of the Bond. However, the important question is whether other factors like the five month default in the payment of interest, gave the Bank the right to make such a demand.

The point in controversy raises an important question as to the manner in which a commercial institution may analyze the security which it holds for a loan. The Court of Appeals in essence held that the Bank had no right to demand an extension of the Bond at any time during the term of the Bond because the amount of the Bond was sufficient to cover the entire indebtedness. This holding only permits a creditor to evaluate collateral on a day by day basis posited upon the face amount of the collateral. Essentially, this means that at the beginning of each day the creditor may evaluate the collateral. If it is sufficient in amount to cover the indebtedness on that day then no demand for additional collateral would be permitted. It would not matter that the collateral would be due to expire

during the renewal term of the note and the creditor would be forced to ignore factors which had arisen during the term of the loan which would give a reasonable creditor cause for concern, in this case a 5 month default in the payment of interest. It must be emphasized that there is a dissenting opinion by Chief Judge Seitz stressing the finding of good faith which was made by the District Court based upon Brokers' failure to pay interest for 5 months.

It is the Bank's position that collateral has more than one dimension. The first dimension, as recognized by the Court of Appeals, is dollar value. However, the second dimension is the duration of the collateral. It is asserted that when a creditor evaluates the sufficiency of colltaeral it should have the right to take into consideration the duration of the collateral. In the present case the pending expiration of the Bond plus the five month default in the payment of interest combined to produce reasonable grounds for insecurity and gave the Bank the right to demand an extension of the Bond. It is therefore asserted that this case presents the court with the important question of the manner in which a creditor may evaluate collateral under the Uniform Commercial Code, and that this question is deserving of certiorari in light of the fact, as stated by the majority opinion, that this issue has never been passed upon by any other court.

CONCLUSION

For the reasons set forth above, Petitioner respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the Third Circuit Court of Appeals.

Respectfully submitted,

/s/ Albert B Melnik
ALBERT B. MELNIK
Attorney for the Petitioner

September 9, 1977

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 76-2069

THE BANK OF NEW JERSEY, a corporation of the State of New Jersey,

v.

BROKERS FINANCIAL CORPORATION (Deft. in D.C.) and NORTHWESTERN NATIONAL INSURANCE COMPANY, (Deft. and 3d-pty. pltf. in D.C.)

v.

BROKERS FINANCIAL CORPORATION AND ROCCO J. MOLINARI and MICHAEL GRASSO, (3d pty. defts. in D.C.)

NORTHWESTERN NATIONAL INSURANCE COMPANY,

Appellant.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

(D.C. Civil No. 929-72)

Argued March 29, 1977

SEITZ, *Chief Judge*, and ALDISERT and HUNTER, *Circuit Judges*

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OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

(Filed June 13, 1977)

HUNTER, *Circuit Judge:*

Northwestern National Insurance Company appeals from a grant of summary judgment against it in the District of New Jersey, holding Northwestern liable on a surety bond to the Bank of New Jersey. The appeal presents the question whether a creditor who has accepted a one-year surety bond as collateral for a five-year loan can use the impending expiration of the bond as grounds for accelerating the entire debt, in an attempt to force the surety to renew its bond. The court below held that the creditor had such power. For the reasons that follow, we reverse.

I.

In February, 1971, the Bank of New Jersey agreed to lend $250,000 to Brokers Financial Corporation over five years, so that Brokers could complete construction of an apartment building in Ventnor, New Jersey. The indebtedness was evidenced by a one-year note at an interest rate of eight percent per annum. The note was renewable solely at borrower's option, so long as interest payments were made as agreed during the first year. There was to be no reduction of principal until the second year of the loan.

As collateral, the Bank required the assignment of a $550,000.00 second mortgage on the apartment building and a surety bond covering the first year of the loan in the full amount of $250,000.00. Brokers obtained the proposed

form of a bond from Northwestern and forwarded it to the Bank on March 31, 1971. A covering letter requested the Bank to have the Bank's attorneys "complete this [bond] in a form acceptable to them. . . ." [1]

On April 7, 1971, Brokers executed and delivered to the Bank a note payable to the order of the Bank one year after date. The note reflected the agreement that only monthly interest was to be paid during the term of the note and included the borrower's option to renew if the interest was paid as agreed.[2] Also, the note contained an acceleration clause [3] of the sort permitted by N.J. Stat. Ann. §12A:1-208.[4]

On April 16, 1971, Northwestern executed and delivered to the Bank the Financial Guarantee Bond in suit,[5] which

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1. Appendix at 46a.
2. *Id.* at 31a.
3. The acceleration clause provided as follows:
[E]ach of the undersigned hereby agrees, whenever the total value of the collateral so held by the holder hereof, shall be insufficient in character, kind or amount in the holder's sole option and discretion to cover all indebtedness and liabilities as aforesaid of any of the undersigned to the holder hereof, with a margin added thereto satisfactory to the holder, to immediately reduce such indebtedness and liabilities or to deposit with the holder additional collateral to the satisfaction of the holder within two hours after demand made orally, or within twelve hours after demand made in writing addressed to the undersigned and delivered at any address shown on the records of the holder hereof, or within twenty-four hours after demand made by letter deposited in the United States mail with postage prepaid addressed to the undersigned at any address shown on the records of the holder hereof, or at the last known residence or place of business of the undersigned, and in default thereof this note shall forthwith without further demand or notice, and regardless of whether otherwise due by the terms hereof or not, become immediately due and payable.
4. Section 1-208, a codification of U.C.C. § 1-208, provides as follows:
A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or "when he deems himself insecure" or in words of similar import shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against whom the power has been exercised.
5. The full text of the bond is as follows:

originally had been transmitted to the bank with instructions to obtain approval of the bank's attorneys. Among

FINANCIAL GUARANTEE BOND
PROMISSORY NOTE

Date: April 16, 1971
Bond No. *NWN 1501*

TO: Bank of New Jersey
Broadway and Market Streets
Camden, New Jersey

Gentlemen:

We, Brokers Financial Corporation, a Pennsylvania corporation, hereinafter called the "Principal," and Northwestern National Insurance Company, a Wisconsin corporation, hereinafter called the "Surety," are held and firmly bound unto the Bank of New Jersey, a New Jersey corporation, hereinafter called the "Obligee," its successors and assigns, as their respective interest may appear, as obligees, in the sum of Two Hundred Fifty Thousand Dollars ($250,000.00), lawful money of the United States of America, for the payment of which Principal and Surety by this instrument jointly, severally, and firmly bind themselves, their successors and their assigns.

Whereas, Obligee has agreed to lend to Principal the sum of Two Hundred Fifty Thousand Dollars ($250,000.00) with the obligation to repay the loan to be evidenced by a certain negotiable promissory note (hereinafter "the note") in form and substance as set out in Exhibit A that is attached hereto and by this reference incorporated herein; and

Whereas, Obligee desires protection, as its interests may appear, in the event that Principal defaults in the payment of the note;

Now, therefore, the condition of this obligation is such that, if Principal shall well and truly perform all of the undertakings, terms, and agreements of the note, this obligation shall be null and void; otherwise it shall remain in full force and effect.

Surety binds itself firmly and certainly unto Obligee to pay the indebtedness of Principal, evidenced by the note, within 30 days from receipt of notice of Obligee of default in the payment thereof.

Surety further agrees that (a) any right of action which Obligee may have under this bond may be assigned to any person, firm, or corporation who or which becomes the bona fide holder in due course of the promissory note hereinabove described and (b) any such assignment will in no manner invalidate or qualify this instrument.

The foregoing, however, is subject to the following further conditions and provisions:

1. The aggregate liability of Surety to Obligee, or to its successors or assigns, is limited to the sum above stated.

2. If, by reason of partial payment of the note, Principal's obligation to Obligee is less than the sum above stated, the liability of Surety hereunder shall not exceed the obligation of Principal to Obligee.

3. Upon making any payment hereunder, to the extent thereof Surety shall be subrogated to all rights or Surety's payee against Principal and/or any other person, firm, or corporation liable to that payee in connection with the default which is the subject of, or occasion for the payment. Further, upon making any payment hereunder, to the extent thereof Surety

its provisions were the following two, upon which this case turns:[6]

7. The term of this instrument is and shall be one year. If Principal exercises its right to renew the note, Surety's obligation hereunder shall not thereby automatically be renewed, but may be renewed at the option of Surety.

8. If, during the term of the note, Principal defaults in the payment of any monthly installments of interest, Obligee shall notify Surety forthwith, and Surety shall have ten days after receipt of such notice in which to cure the default and thereby preserve all of the Principal's rights which, in that event, shall remain in full force and effect.

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shall be entitled to an assignment of the note and the instruments of collateral referred to in paragraphs numbered 5 and 6 hereinunder.

4. No suit, action, or proceeding shall be brought on this bond more than two years after maturity date of the note.

5. The note and the payment thereof shall be secured by collateral to be assigned to and held by Principal, such collateral to be (a) a mortgage generally in form and substance as set out in Exhibit B that is attached hereto and by this reference incorporated herein and (b) a Bond and Warrant generally in form and substance as is set out in Exhibit C that is attached hereto and by this reference incorporated herein.

6. In taking and securing the collateral referred to in the paragraph immediately next preceding, Obligee may employ whatever valid and effective means or instruments it chooses.

7. The term of this instrument is and shall be one year. If Principal exercises its right to renew the note, Surety's obligation hereunder shall not thereby automatically be renewed, but may be renewed at the option of Surety.

8. If, during the term of the note, Principal defaults in the payment of any monthly installment of interest, Obligee shall notify Surety forthwith, and Surety shall have ten days after receipt of such notice in which to cure the default and thereby preserve all of Principal's rights which, in that event, shall remain in full force and effect.

9. Of the proceeds of the loan to be made by Obligee to Principal, as aforesaid, Two Hundred Twenty-five Thousand Dollars ($225,000.00) shall be expended for (a) labor and materials to be directly incorporated in the improvement of the real property described in Exhibit B hereof, (b) real estate taxes against that real property, and (c) interest owed on the first mortgage against that real property; and Obligee shall disburse the loan proceeds accordingly.

SIGNED AND SEALED this 16th day of April, 1971.

6. Appendix at 35a-36a.

Brokers faithfully made all interest payments through November, 1971. At that time, difficulties arose at the apartment complex, and interest payments ceased. Although Northwestern had not been notified of Brokers' failure to pay, the Bank, by letter of March 3, 1972,[7] notified Brokers of its intention to turn to the bond for payment:

> Since there is now a default in the Note due to the nonpayment of interest from November 7, 1971, to March 7, 1972, in the amount of $6,622.09, we must under the terms of Paragraph 8 notify the "Surety" immediately and call for payment under the Bond. . . .

On March 8, 1972, the Bank—apparently concerned about the value of the mortgage securing its five-year loan—asked Brokers to obtain by March 14, 1972, an extension of Northwestern's surety bond.[8] This letter produced no results, and on March 15, 1972, counsel for the Bank notified Northwestern for the first time that "there has been a default in the payment of interest," recited verbatim the language of paragraph 8 of the bond, set forth above, and requested payment of the interest arrearages. On March 24, 1972, Northwestern paid the outstanding interest on the note, to and including that due for March, 1972, in fulfillment of its obligation under the bond and in preservation of all of Brokers' rights under the note.[9] At oral argument before this court, counsel agreed that this payment had cured any default.

Nevertheless, by letter dated April 5, 1972,[10] the Bank notified Brokers that "due to the default in the note . . ., we do not wish to extend the loan and are hereby demanding payment be made prior to 3:00 P.M. on Friday, April 7, 1972." Believing that all its rights under the note—

7. *Id.* at 53a.
8. *Id.* at 55a.
9. *Id.* at 58a.
10. *Id.* at 60a.

including the right to renew—had been preserved by Northwestern's payment of the interest arrearages, Brokers tendered the April interest on April 6, 1972, and informed the Bank that it was renewing the note.[11] The Bank returned the tendered interest payment and repeated its refusal to extend the loan "due to the default in the note." [12]

Brokers refused to pay the full balance of the note, and the Bank on April 11, 1972, made demand upon Northwestern for payment of the principal sum plus interest from March 7, because the "principal sum had not been paid. . . ." [13] Northwestern also refused to pay, contending that there had been no uncured default that could have obligated it to pay on its bond.

On May 31, 1972, the Bank filed in the District of New Jersey a complaint, based on diversity of citizenship, against both Brokers and Northwestern. On July 17, 1972, default judgments were entered as to both defendants, but on July 20, 1972, the default was vacated as to Northwestern. The parties filed cross-motions for summary judgment, and on December 5, 1975, the district court granted the Bank's motion and denied Northwestern's.

The court found that the "default" in interest payments had been cured in accordance with the terms of the bond,[14] but it discovered another "default" that, it concluded, had triggered Northwestern's obligation to pay on its bond. The court observed that the note in question contained a typical acceleration clause: if the holder of the note deemed the total value of the collateral insufficient to secure the entire indebtedness, the holder could demand a reduction of indebtedness or the deposit of "additional collateral"; in default of those demands, the note would immediately become due. As the district court viewed

11. *Id.* at 64a.
12. *Id.* at 65a.
13. *Id.* at 66a.
14. Appendix at 77a. Appellee does not dispute that finding.

the case,[15] the default in interest payments gave the Bank a substantial basis for believing its prospects for payment were impaired. The Bank then justifiably requested "additional collateral" in the form of an extension of Northwestern's bond, which was due to expire. When Brokers failed to produce this "additional collateral," said the district court, the note fell due in full under the acceleration clause; Brokers' subsequent refusal to pay amounted to a default for which the surety, Northwestern, was liable on its bond.

Northwestern appealed from the denial of its motion for summary judgment and the grant of summary judgment against it. Because we believe that the court below improperly interpreted the note's acceleration clause, we reverse.

II.

Under the terms of the bond it executed and delivered to the Bank, Northwestern agreed to perform two duties: (1) to cure defaults in interest payments within ten days of notice from the Bank during the term of the bond (one year), and (2) to assume the risk of Brokers' default on the note occurring during the term of the bond (one year). It is undisputed that the default in interest payments was timely cured and forms no basis for holding Northwestern liable on its bond. The only question before us is whether the Bank's demand for an extension of Northwestern's bond was a demand for "additional collateral" within the meaning of the note's acceleration clause. Counsel have been unable to cite any cases on point. Unable to find a precedent, we must—contrary to Dean Griswold's admonition—make one.[16]

15. On the record before us, there is no indication that this theory was even argued to the court.

16. Griswold, *The Judicial Process*, 31 Fed. B.J. 309 (1972), *reprinted in* R. Aldisert, *The Judicial Process* 128, 129 (1976).

Our research discloses that only a few cases have dealt with U.C.C. §1-208, *see* note 4 *supra*, and none of those has involved the question presented here. *See* Jensen v. State Bank, 518 F.2d 1 (8th Cir. 1975) (good faith); Sheppard Fed. Credit Union v. Palmer, 408 F.2d 1369 (5th Cir. 1969) (same); Elevator, Inc., Duncombe v. State Bank, — Iowa —, 236 N.W.2d 674 (1975) (same); Van Horn v. Van De Wol, 6 Wash. App. 955, 497 P.2d 252 (1972) (same); Seay v. Davis, 246 Ark. 198, 438 S.W.2d 479 (1969) (same); Merchant v. Worley, 79 N.M. 771, 449 P.2d 787 (1969) (burden of proof); Fort Knox Nat'l Bank v. Gustafson, 385 S.W.2d 196 (Ky. 1964) (same); Simon v. New Hampshire Sav. Bank, 112 N.H. 372, 296 A.2d 913 (1972) (coverage of demand instrument); Klingbiel v. Commercial Credit Corp., 439 F.2d 1303 (10th Cir. 1971) (provision of notice); Chrysler Credit Corp. v. Burnes, 126 Ga. App. 444, 191 S.E.2d 721 (1972) (same); Fay v. Marina, Inc., 6 UCC Rep. Serv. 516 (N.Y. Sup. Ct. 1969) (coverage of "default" clause). For a general discussion of §1-208, see Note, *Acceleration Clauses in Sales and Secured Transactions: The Debtor's Burden Under Section 1-208 of the U.C.C.*, 11 B.C. Ind. & Com. L. Rev. 531 (1970).

Undeniably, the Bank at no time prior to the institution of these proceedings acted as though its refusal to extend the term of the note was founded upon the acceleration clause. Indeed, every reference to "the default" in the correspondence cited above seems clearly to refer to the interest arrearages from November to March.[17]

Even apart from inquiries into what the parties "really" did, these facts simply cannot be stretched to fit the theory of the court below. There never came a time during the one-year term of the note when the collateral was insufficient to cover all the indebtedness; in fact, Northwestern's bond alone covered the full face amount of the note. The Bank's request for a new bond—also in the amount of $250,000.00—to cover the second year of the note, demonstrates that the first-year collateral was sufficient. The Bank, then, was not requesting additional collateral to secure the indebtedness evidenced by the one-year note to which the bond referred.[18]

17. The Bank was quite properly worried about the implications of the failure to pay the interest: cash flow problems at the apartment building lessened the value of the second mortgage given the Bank and impaired prospects for future repayment. But Northwestern's prompt payment eliminated those arrearages as a source of "default."

18. It is significant that the bond, as approved by the Bank, was expressly executed for a year, with option to renew vested solely in Northwestern. See paragraph 7 of the bond, *supra* at note 3.

The Bank argues instead that, with the impending expiration of the one-year bond, the collateral *was about to become* insufficient. That was true, but not because the commercial value of the item constituting the collateral had diminished.[19] The risk of that diminution, in light of the acceleration clause, quite properly would have fallen upon the borrower. Instead, it was true because the item serving as collateral was, as the Bank had previously agreed, about to cease existing. In light of the Bank's initial contractual acquiescense in that impending quietus, it appears unfair to shift the burden of it entirely onto Brokers (and thus the surety) *while the note was still fully secured* (by virtue of surety's guarantee bond itself).

To allow the Bank to declare a default during the term of the bond, while the bond itself completely covered the full indebtedness, would be to convert the very act of executing a bond for a term shorter than that of the principal debt into a sufficient condition for the declaration of a default which triggers liability on the bond. For example, the Bank in this case bargained for and obtained what it thought was sufficient collateral in the form of a one-year bond. If the impending lapse of that bond after one year was itself the condition creating present insecurity (and hence default), then the express language limiting the bond to a term of one year and vesting the renewal option exclusively in the surety was meaningless; unless Northwestern extended the bond at the *Bank's option*, a default would occur. Thus, following the logic of the court below, sureties effectively would be precluded from executing guarantee bonds for a term shorter than that of the principal debt; refusal to extend for the future

19. The mortgage can be omitted for purposes of analysis, since the risk of a decline in the value of a mortgage is always present. Moreover, the Bank's vice president in charge of the loan admitted that it was based on the bond rather than the mortgage, which did not cover the full face amount. Oral deposition of Robert N. Fitzgerald, Apr. 14, 1973, at 16.

would simply lead to immediate insecurity and default, triggering liability on the bond.[20]

That seems an absurd result. If a bank considers a one-year bond too short for its own security, it can bargain with the borrower to pay the additional sum required to obtain a longer-term bond. But if the bank declares itself satisfied with a shorter-term bond, the surety is lured blindly into the snare: if the bank decides that expiration of the bond in the future will render the loan partially unsecured, the surety must provide regular extensions amounting to a longer-term bond, without gaining the additional consideration ordinarily asked for the longer-term bond. Otherwise, an immediate default will occur.[21]

Of course, the surety could protect itself by refusing to issue bonds for less than the full term of the principal

20. Thus, we cannot agree with the dissent's view that the bank's right to demand collateral automatically created a corresponding right in the bank to condition its acceptance of the borrower's renewal of the note upon renewal of the bond. The power to renew the note was lodged exclusively in the borrower, provided there was no uncured default—and there was none. The power to renew the bond was lodged expressly in the surety. Those were the contractual terms for which the bank bargained. The dissent's creation of an implicit right in the bank to reject renewal of the note simultaneously creates—in practical effect—a right to compel renewal of the bond. There is no reason for this court to stretch plain contractual terms to protect a commercial institution from the consequences of its own bad bargain.

21. Recognition that the bank can request additional collateral only in "good faith" does not, contrary to the dissent's suggestion, solve the surety's problem. Any time the bank—as here—extends a loan secured primarily by a bond shorter than the term of the loan, it will *always* have a good faith belief that, upon expiration of the bond, its collateral will be impaired. Yet the shorter bond is all the bank bargained for.

The dissent's error inheres in assuming that the bank must have a good faith belief that *default* is likely and, therefore, that the surety is protected against bank-imposed renewals in cases where the loan is safe. Even if that were a sufficient basis for judicial alteration of the bank's bad bargain—and we think it is not—it simply is not true. Under the acceleration clause, the bank need only have a good faith belief that its *collateral is insufficient* to cover the entire indebtedness. And as pointed out above, such a good faith belief will *always* arise in cases where the bank bargains for and extends a loan on the basis of a bond with a term shorter than that of the loan. Thus, the dissent's assertion that the good faith requirement cannot be met when premised solely on the expiration of the bond is simply at odds with the plain language of the acceleration clause. See note 3 *supra*.

debt and requiring the appropriate consideration. We cannot see the value, however, of creating such rigidity in the money market. The Bank here decided, as a matter of business judgment, that a one-year bond would be sufficient; it bargained for only a one-year bond, presumably making it less expensive for the borrower to obtain the loan. That flexibility would disappear if sureties were forced to execute, and charge for, only bonds covering the full term of the principal debt. Certainly there is no reason for the federal diversity courts to create that situation in an effort to protect lending institutions from the overreaching of surety companies.

Broad questions of the lender's right to accelerate because of prospective impairment are not before us. We hold only that the Bank's right to demand "additional collateral" cannot be understood to mean that the Bank could demand a "temporal extension of the *same* collateral," where the parties explicitly bargained for the expiration of the collateral—the bond—at a precise date within the term of the principal debt, and where that agreed-upon collateral currently covered the full indebtedness. The judgment of the district court will be reversed.

SEITZ, *Chief Judge*, dissenting.

The issue here is whether the debtor, Brokers Financial Corporation, defaulted on any obligations under its note to the Bank within the term of the Financial Guarantee Bond. The district court concluded that Brokers had failed to comply with a good faith timely demand for additional collateral, and that the Bank was therefore justified in calling the principal when Brokers defaulted on its obligation to do so. The court found that Brokers' failure to pay interest from November 7, 1971 to March 7, 1972

was sufficient to "make a reasonable and honest creditor doubt the security of [the] loan beyond the first year." I see no basis for overturning this finding of fact. But while the finding is relevant, it is not a sufficient basis on which to conclude that Northwestern may be held liable on the Bond. The Bond and a $500,000 Second Mortgage on certain real estate, which the Bank also held, were clearly sufficient to secure all obligations which could be due during the first year of the note. Unless the note was to be renewed beyond the first year, the Bank had no reason to worry about the security of its obligations. Thus, the mere fact that the note *might* be renewed is not, in my view, sufficient to allow the Bank to make a good faith demand for additional collateral.

This, however, does not end the problem. The note was payable April 7, 1972, unless validly renewed. The Financial Guarantee Bond expired April 15, 1972. Thus, unless all obligations under the note were paid on April 7, 1972, or the note was validly renewed, the Bank could demand that Northwestern make good its obligations under the Bond.

The principal due under the note was never paid. Nor was the note validly renewed, though Brokers' attorney attempted to renew it. It is true that the note states that: "[a]lthough written for a period of 1 year, if interest is paid as agreed, this Note may be renewed." Moreover, the Bond states that: "[i]f, during the term of the note, Principal defaults in the payment of any monthly installment of interest, Obligee shall notify Surety forthwith, and Surety shall have ten days after receipt of such notice in which to cure the default and thereby preserve all of the Principal's rights which, in that event, shall remain in full force and effect." Thus, since Northwestern made good its obligation to tender the interest payments

on which Brokers had defaulted, Brokers' default in paying interest did not preclude it altogether from renewing the note. Nonetheless, I conclude that Brokers was not entitled to renew the note, because it had failed to comply with the Bank's demand that it provide additional collateral [1]—a demand which, as the district court found, was based on good faith uncertainty as to the Bank's security beyond the first year.

The note does not expressly give the Bank the right to condition renewal upon satisfaction of any good faith demands for additional collateral. But I believe that this right is inherent in the right to demand additional collateral: even if one should give Brokers the unqualified right to renew, the Bank would still have the option of immediately demanding additional collateral on the renewed note, and then calling all obligations due if this demand were not satisfied. Moreover, the course of dealings between the parties to the transaction shows that the Bank did demand additional collateral in connection with the renewal of the note. The Bank's letter dated March 8, 1972 to Rocco J. Molinari, President of Brokers, said that "at or prior to [March 14, 1972] you will present to us an extension of the Financial Guarantee Bond, Promissory Note of the Northwestern National Insurance Company . . ." The extension of the Bond must contemplate renewal of the note.

I do not understand the majority to question the proposition that the Bank could, in the proper circumstances, demand more collateral to secure obligations which had not yet matured. Rather, the majority stress that "[t]o allow the Bank to declare a default during the term of the bond, while the bond itself completely covered the full indebtedness, would be to convert the very act of executing a bond for a term shorter than that of the principal debt into a sufficient condition for the declaration of a default which triggers liability on the bond." I believe this conclusion to be in error. The Bank would have no right to demand additional collateral of Brokers unless it could do so in good faith. In my view, this requirement of good faith would not be satisfied if the sole basis for the demand were the impending expiration of the Financial Guarantee Bond. The present case, however, is different, since Brokers had failed to pay interest from November 7, 1971 to March 7, 1972.

1. I need not discuss the Bank's contention that there was no effective renewal of the note because Brokers never tendered a proper renewal note.

While the result reached by the district court may seem harsh, I believe that it is correct because the Bond extends Northwestern's obligations as surety until April 15, 1972, and thus to any default in the payment of principal at the end of the first year of the note.

I would affirm the grant of summary judgment for the plaintiff.

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit.

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the District of New Jersey and was argued by counsel March 29, 1977.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed June 11, 1976, be, and the same is hereby reversed. Costs taxed against the appellee.

ATTEST:

/s/ Thomas F. Quinn
Clerk

June 13, 1977

HEARING AND OPINION OF THE COURT: CROSS MOTIONS FOR SUMMARY JUDGMENT ON THE ISSUE OF DAMAGES BEFORE THE HON. JOHN F. GERRY, U.S.D.J., DATED JUNE 4, 1976

(2) THE COURT: Gentlemen, we have lived, each and everyone of us, with this case for lo these many years. We are all familiar with it. We could almost recite word for word the position and philosophies of our adversaries. I read your briefs when this motion for summary judgment was brought by the plaintiff originally, which I denied as being premature at that time. I read the briefs then. I have read the briefs in support of the plaintiff's renewed motion for summary judgment. I have read carefully the briefs in support of the defendant carrier's cross motion for summary judgment. I am very, I think, familiar with your legal positions.

I am very happy to see that we have at last reached that moment where no one seems to feel we have any genuine issues of material fact outstanding, that there is but a legal question on who ought to get a summary judgment. That, it seems to me, is a giant stride forward. So, now we have a legal question. So, what I'm trying to say to you, I don't want to disabuse you from saying what you want to say, but I am very familiar with your positions. I'd be very surprised to hear anything this morning that I haven't already (3) heard or read before.

So, with that, good morning, Mr. Melnik.

MR. MELNIK: Good morning, your Honor.

MR. MC CONNELL: As your Honor knows, it's for precisely those reasons that I've offered to submit these on briefs.

MR. MELNIK: If your Honor feels that the court is totally familiar with all of the facts and that oral argument will not add anything to what's been submitted in the form of a brief, then I say that oral argument will be futile.

THE COURT: Well, you put me in a very uncomfortable position with the use of the word "totally," which I suppose is a subjective conclusion, and someone may not feel from the results of these cross motions that the judge was totally familiar. I would never acknowledge the oral argument before this court is futile; that suggests some sort of predisposition not to listen.

MR. MELNIK: Well, perhaps the word was used unappropriately, the word "futile."

THE COURT: No, Mr. Melnik, I'm just kidding. But I don't really think oral argument is going to help any side one way or the other. I don't think it's going to be very helpful to me. But, (4) again, let the record show that I invite oral argument and I do not refuse an opportunity from anyone to orally argue these motions.

MR. MELNIK: Well, may I say this, sir, perhaps I'm repeating myself: if the court feels, and it has so expressed itself, that the question at issue has been completely covered by both sides–

THE COURT: Yes, I do think that. I think the briefs have covered all the points that I can think of and I think the legal research and arguments have been well presented on both sides; and there's no remaining dispute by agreement of both Mr. McConnell and yourself that there remains and dispute as to facts and everybody thinks on the undisputed stipulated facts that they're entitled to summary judgment.

MR. MELNIK: Then I move for summary judgment on the issue of damages in behalf of the plaintiff and ask

that the summary judgment on behalf of the defendant be denied.

THE COURT: All right. I'm quite sure that you move the same way.

MR. MC CONNELL: We have, in fact, filed such a motion, if your Honor please.

(5) THE COURT: You are in agreement?

MR. MC CONNELL: Right, if your Honor please.

THE COURT: All right, gentlemen. As I said, I'm very happy from review of the current briefs and correspondence and so on with the court, those that have been submitted in opposition to and in support of motions this morning, that the parties agree to rely upon the facts stipulated and from their reliance upon the financial guarantee bond-promissory note. Now, that's what we're dealing with here, that's what it's entitled. The question is: what kind of animal do we have? The court's disposition of that first question will be very important.

Apparently the parties were, one or both, were motivated to feel that there is no longer any significance or material genuine issue of material fact involved and, perhaps, this was in part by virtue of the discovery that was allowed by the court and which discovery, of course, was one of the reasons why the court denied without prejudice the plaintiff's earlier application for summary judgment. This court agrees that this matter is now ripe for disposition by summary (6) judgment, which is an expression which the defendant carrier has used somewhere in his brief, and that is ripe for disposition as a matter of law.

The court further agrees that the instrument in question must be construed in the context of an overview of all of the four corners of the instrument–by "instrument,"

again, I mean financial guarantee bond-promissory note, which will hereafter be referred to by me as "the bond"—and that this review of the bond should be unrestricted by any nice technical labels that might be applied to it; that the terms of the bond and the wording must be given their ordinary and plain meaning. The court also agrees that the instrument is unambiguous and that both the fair intention of the parties to it, as well as its legal effect may be determined by the court without recourse to any extrinsic evidence. Thus, the court finds that there is no issue of fact raised by evidence *alliunde* separate and apart from the instrument which the court must or should consider in its construction of this instrument.

Time honored rules of construction also require that this bond be construed most strongly (7) against the defendant carrier who has authored it. But there seems to this court to be abundant evidence from the face of the instrument itself, from the wording used in the instrument, that compels this court to conclude as a matter of law that it is a guarantee of payment not of collection.

The court largely adopts without delineation here the reasons advanced by plaintiffs in their briefs submitted in support affirmatively of their own motion. Apart from Northwestern's contention that it's entitled to credit for loan monies which were applied to property on which the plaintiffs held a first mortgage, and apart from its argument for equitable credit in this action for the fair market value of the property, which the defendant carrier has asserted has appreciated in value to the benefit of the plaintiff-first mortgagee at the date of foreclosure sale, both of which arguments are rejected as inapplicable and irrelevant here, there appears to be no dispute that Brokers Mortgage or Northwestern have not made directly any payments of principal to the plaintiff, nor has Northwestern made any payments of interest, I gather, since 3/7/72.

MR. MELNIK: That's right, sir.

(8) THE COURT: Thus, both the legal effect of the financial guarantee bond and the precise nature and amount and dimension, if you will, all the niceties for computation of the carrier's obligation here appear unambiguously also from the face of the instrument, and from which results this court's granting of the plaintiff's motion for summary judgment on the issue of damages in the amount of the outstanding and unreduced principal and interest from that date.

MR. MELNIK: Yes, sir.

THE COURT: I think this had been set forth in the affidavit of one of the bank's officers that accompanies one of your earlier submissions.

MR. MELNIK: It has.

THE COURT: I haven't computed the actual figure, I don't think it's necessary for this court to do so.

MR. MELNIK: It has been set forth as of interest of the particular date the affidavit was taken, sir.

THE COURT: All right. It's the court's intention to award, therefore, full principal and interest and costs. Defendant Northwestern's motion for summary judgment is, of course, respectfully (9) denied.

Thank you very much, gentlemen.

MR. MELNIK: Thank you, judge. I'll submit an appropriate order.

MR. MC CONNELL: Thank you, your Honor.

THE COURT: Thank you, gentlemen.

(At which time the hearing then ended.)

° ° °

CERTIFICATE

I, Theodore M. Formaroli, a certified shorthand reporter and Notary Public in and for the State of New Jersey do hereby certify the foregoing to be a true and accurate transcript of my stenographic notes taken at the time and place hereinbefore set forth.

/s/ Theodore M. Formaroli
THEODORE M. FORMAROLI, CSR
Official Reporter
Registered Professional Reporter

Date: 9/10/76

ORDER FOR SUMMARY JUDGMENT IN FAVOR OF PLAINTIFF ADJUDGING LIABILITY OF NORTHWESTERN NATIONAL INSURANCE COMPANY ON ITS FINANCIAL GUARANTY BOND

(Filed February 17, 1976)

This matter being opened to the Court by Melnik, Morgan, Weinberg and Weiner, a Professional Corporation, attorneys for the plaintiff, upon an application for summary judgment in favor of the plaintiff and against the defendant, Northwestern National Insurance Company, adjudging the liability of said insurance company on a financial guaranty bond dated April 16, 1971, executed by it in favor of plaintiff, and said defendant having made a motion for summary judgment against the plaintiff on the question of liability only, and the matter having been submitted to the Court upon a stipulated record of facts and exhibits, and the Court having made certain findings of fact and conclusions of law thereon, granting plaintiff's motion for summary judgment and denying the cross-motion of the defendant, Northwestern National Insurance Company, and said defendant having made a motion for reconsideration of the Court's findings of fact and conclusions of law, and the Court having heard said motion on February 6, 1976, and having determined that the motion for reconsideration should be denied on the ground that the relief sought thereby had already been considered by the Court in its original findings of fact and conclusions of law, and no good cause appearing to the contrary;

IT IS THEREUPON ON THIS 11TH DAY OF FEBRUARY, 1976,

ORDERED that summary judgment be and the same is hereby entered in favor of the plaintiff and against the defendant, Northwestern National Insurance Company,

adjudging that the said defendant, Northwestern National Insurance Company, is liable on the financial guaranty bond executed by it in favor of the plaintiff and dated April 16, 1971; and

IT IS FURTHER ORDERED that the motion of Northwestern National Insurance Company against the plaintiff for summary judgment be and the same is hereby denied.

/s/ John F. Gerry
JOHN F. GERRY, J., U.S.D.C.

OPINION OF JUDGE JOHN F. GERRY

GERRY, Judge

This is a diversity action initiated by plaintiff Bank against a borrower, Brokers Financial Corporation, and its surety, Northwestern National Insurance Company. The amount in controversy exceeds $10,000.00.

On July 17, 1972, default judgment was entered against both Brokers Financial Corporation and Northwestern National Insurance Company for failure to appear and answer. On July 20, 1972, the default was vacated as to defendant, Northwestern National Insurance Company.

This case is presently before the Court on cross-motions for summary judgment on the liability issue only. A stipulated record of facts and exhibits submitted to the Court by the Bank and Northwestern National Insurance Company is the basis for the following findings of fact:

I. FINDINGS OF FACT

1. The Bank of New Jersey loaned $250,000.00 to Brokers Financial Corporation agreeing that the full term of the loan shall be for five years with a principal repayment schedule during the last three years.

2. On April 7, 1971, the Bank and Brokers Financial Corporation executed a one-year note for $250,000.00 providing for monthly interest payments at the rate of 8% per annum. The words, "although written for a period of one year, if interest is paid as agreed, this note may be renewed," were typed upon the note.

3. This standard note also provided that:

". . . each of the undersigned hereby agrees, whenever the total value of the collateral so held by the

holder hereof, shall be insufficient in character, kind or amount in the holder's sole option and discretion to cover all indebtedness and liabilities as aforesaid of any of the undersigned to the holder hereof, with a margin added thereto satisfactory to the holder, to immediately reduce such indebtedness and liabilities or to deposit with the holder additional collateral to the satisfaction of the holder within two hours after demand made orally, or within twelve hours after demand made in writing addressed to the undersigned and delivered at any address shown on the records of the holder hereof, or within twenty-four hours after demand made by letter deposited in the United States mail with postage prepaid addressed to the undersigned at any address shown on the records of the holder hereof, or at the last known residence or place of business of the undersigned, and in default thereof this note shall forthwith without further demand or notice, and regardless of whether otherwise due by the terms hereof or not, become immediately due and payable.

4. As collateral for this loan, Brokers Financial Corporation assigned a second lien to the Bank on the property located in Ventnor, New Jersey, and a $250,000.00 Financial Guarantee Bond issued by Northwestern National Insurance Company.

5. The Bond, dated April 16, 1971, provided for a one-year term with an option for renewal retained by the Surety. If during the term of the note the principal defaulted in any monthly installment of interest, the Bank was to notify the Surety, and the Surety would have ten days in which to cure the default and preserve the principal's rights.

6. On March 3, 1972, the Bank notified Brokers Financial Corporation of their non-payment of interest from November 7, 1971 to March 7, 1972, in the amount of $6,622.00 and default on the loan.

7. On March 8, 1972, the Bank notified Brokers Financial Corporation of a meeting to be held on March 14, 1972, at which time Brokers Financial Corporation was to present an extension of the Financial Guarantee Bond and a check for the interest past due.

8. On March 15, 1972, the Bank's counsel notified the Surety of Brokers Financial Corporation's default in interest payments who forwarded the past due interest to the Bank in accordance with the terms of the Bond.

9. On April 5, 1972, the Bank notified Brokers Financial Corporation that "due to the default" in their note, the Bank would not extend the loan and demanded full payment on April 7, 1972.

10. On April 6, 1972, Brokers Financial Corporation forwarded $1,666.67 to the Bank as the interest from March 7, 1972 to April 7, 1972, and stipulated their desire to renew the note.

11. The Bank returned the check for $1,666.67 on April 7, 1972, demanding full payment of the note, plus interest due to the default resulting from Brokers Financial Corporation's failure to make timely interest payments and to present an extension of the Financial Guarantee Bond as demanded in the letter of March 8, 1972.

12. On April 11, 1972, the Bank demanded $250,000.00, plus interest from March 7, 1972 to date of payment from Northwestern National Insurance Company.

13. Plaintiff remains unpaid as to the entire $250,000.00 loaned plus interest thereon from March 7, 1972.

II. CONCLUSIONS OF LAW

The Uniform Commercial Code at N.J.S.A. 12A:1-208 provides that:

> A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or "when he deems himself insecure" or in words of similar import shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against whom the power has been exercised.

Therefore, contract clauses permitting acceleration of the payment of a debt on the occasion of the insecurity of the creditor are expressly allowed under the Code. In determining whether the creditor's insecurity was justified, Section 1-208 adopts a good faith standard; i.e., the creditor must in good faith believe that the prospect for payment is impaired in order to lawfully accelerate the payment of the debt. Good faith is defined in the Code at N.J.S.A. 12A:1-201(19) as "honesty in fact in the conduct or transaction concerned." This obligation of fair dealing interjected into Section 1-208 requires that the creditor honestly believe that the security is endangered in order to justify the acceleration of payment. The burden of establishing the lack of good faith in so doing is upon the party upon whom the option to accelerate has been exercised.

The terms of the loan between the Bank of New Jersey and Brokers Financial Corporation correlate with the construct delineated by Section 1-208. The full term of the

loan was five years with a one year renewable note, and the note expressly authorized demands by the Bank for additional collateral when in its sole opinion the collateral on the loan was insufficient. This agreement permitted an evaluation of the security of the loan by the Bank and demands for additional collateral when in good faith it believed its prospects for payment were impaired. Failing to receive that collateral, the note was not renewable but became due and payable resulting in the acceleration of the five year loan.

Given the nature of this agreement, the issue in this case is whether the stipulated factual record accords a substantial basis for the Bank's insecurity and subsequent demand for additional collateral for the second year of the loan in the form of an extended Financial Guarantee Bond. The Court finds that the five months in which Brokers Financial Corporation failed to make timely interest payments would make a reasonable and honest creditor doubt the security of this loan beyond the first year. Surely the common knowledge of all parties here of Brokers Financial Corporation's substantial default in interest payments during the first year of the five-year loan should have alerted borrower and Surety alike that the lender would refuse renewal of the note and demand acceleration of payment upon the prospect of receiving less security in the second and ensuing years of the loan than had been initially demanded as a condition of the loan. It was at that point that the Bank demanded the past interest and the extension of a Financial Guarantee Bond. Brokers Financial Corporation failed to comply with that legitimate demand authorizing the Bank to accelerate the payment of the debt to one year and obligating Northwestern National Insurance Company to pay the guaranteed $250,000.00, upon the default of Brokers Financial Corporation to do so.

Accordingly, plaintiff's motion for summary judgment as to liability is granted, and defendant Northwestern National Insurance Company's motion for summary judgment is denied. Counsel for the plaintiff shall prepare and submit the appropriate order. Trial on the issue of damages will follow the submission of briefs in this remaining issue, such briefs to be submitted to the Court within 14 days of the receipt of this Opinion by counsel for the parties.

/s/ John F. Gerry
JOHN F. GERRY, U.S.D.J.

Dated: December 5, 1975

ORDER FOR SUMMARY JUDGMENT AS TO LIABILITY

(Filed December 11, 1975)

This matter being opened to the Court by Melnik, Morgan, Weinberg & Weiner, Attorneys for Plaintiff, in the presence of Brown, Connery, Kulp, Willie, Purnell & Greene and Morgan, Lewis & Bockius, Attorneys for Defendant, Northwestern National Insurance Company upon an application for summary judgment in favor of the plaintiff and against said defendant, Northwestern National Insurance Company, as to liability and a counter motion for summary judgment by said defendant against the plaintiff on said ground only, and the Court having reviewed the stipulated facts and briefs of counsel and being satisfied that the relief sought by plaintiff should be granted and that the relief sought by said defendant denied, and no good cause appearing to the contrary or being shown,

IT IS THEREUPON ON THIS 11th DAY OF DECEMBER, 1975,

ORDERED AND ADJUDGED that plaintiff's motion for summary judgment as to the liability of Northwestern National Insurance Company be and the same is hereby granted and the counter motion for summary judgment of the defendant, Northwestern National Insurance Company be and the same is hereby denied.

/s/ John F. Gerry
JOHN F. GERRY, U.S.D.J.